

Report
of the
Examination of
Wausau General Insurance Company
Wausau, Wisconsin
As of December 31, 1999

TABLE OF CONTENTS

| | Page |
|--|------|
| I. INTRODUCTION | 1 |
| II. HISTORY AND PLAN OF OPERATION | 4 |
| III. MANAGEMENT AND CONTROL | 9 |
| IV. AFFILIATED COMPANIES | 13 |
| V. REINSURANCE | 22 |
| VI. FINANCIAL DATA | 25 |
| VII. SUMMARY OF EXAMINATION RESULTS | 34 |
| VIII. CONCLUSION | 40 |
| IX. SUMMARY OF COMMENTS AND RECOMMENDATIONS..... | 41 |
| X. ACKNOWLEDGMENT | 42 |



State of Wisconsin / OFFICE OF THE COMMISSIONER OF INSURANCE

Jim Doyle, Governor
Jorge Gomez, Commissioner

Wisconsin.gov

February 5, 2001

125 South Webster Street • P.O. Box 7873
Madison, Wisconsin 53707-7873
Phone: (608) 266-3585 • Fax: (608) 266-9935
E-Mail: information@oci.state.wi.us
Web Address: oci.wi.gov

Honorable Alfred W. Gross
Chairperson, Financial Condition (E)
Committee
Secretary, Southeastern Zone, NAIC
Commonwealth of Virginia
Tyler Building
Post Office Box 1157
Richmond, Virginia 23218

Honorable Susan F. Cogswell
Secretary, Northeastern Zone, NAIC
Commissioner of Insurance
State of Connecticut
153 Market Street 7th Floor
Hartford, Connecticut 06103

Honorable Sally McCarty
Secretary, Midwestern Zone, NAIC
Commissioner of Insurance
State of Indiana
311 West Washington Street, Suite 300
Indianapolis, Indiana 46204-2787

Honorable John Morrison
Secretary, Western Zone, NAIC
Commissioner of Insurance
State of Montana
840 Helena Avenue
Helena, Montana 59601

Honorable Jorge Gomez
Commissioner of Insurance
State of Wisconsin
125 South Webster Street
Madison, Wisconsin 53702

Commissioners:

In accordance with your instructions, a compliance examination has been made of
the affairs and financial condition of:

WAUSAU GENERAL INSURANCE COMPANY
Wausau, Wisconsin

and this report is respectfully submitted.

I. INTRODUCTION

The previous examination of the company was conducted in 1997 and 1998 as of
December 31, 1996. The current examination covered the intervening period ending
December 31, 1999, and included a review of such subsequent transactions as deemed
necessary to complete the examination.

The examination consisted of a review of all major phases of the company's operations and included the following areas:

- History
- Management and Control
- Corporate Records
- Conflict of Interest
- Fidelity Bonds and Other Insurance
- Employees' Welfare and Pension Plans
- Territory and Plan of Operations
- Affiliated Companies
- Financial Experience of the Company
- Reinsurance
- Financial Statements
- Accounts and Records
- Data Processing

Emphasis was placed on the audit of those areas of the company's operations accorded a high priority by the examiner-in-charge when planning the examination.

The section of this report titled "Summary of Examination Results " contains comments and elaboration on those areas where adverse findings were noted or where unusual situations existed. Comment on the remaining areas of the company's operations is contained in the examination work papers.

The company is annually audited by an independent public accounting firm as prescribed by s. Ins 50.05, Wis. Adm. Code. An integral part of this compliance examination was the review of the work papers prepared by the company's independent public accounting firm. Based on the results of the review of these work papers, alternative or additional examination steps deemed necessary for the completion of this examination were performed. The examination work papers contain documentation with respect to the alternative or additional examination steps performed during the course of the examination.

Actuarial Review by PricewaterhouseCoopers LLP

Since January 1, 1999, the company has been a participant in a reinsurance pooling agreement with Liberty Mutual Insurance Company and certain of its property and casualty insurance subsidiaries and other affiliates. The company's net loss and loss adjustment expense reserves are the product of the reserves of the Liberty Mutual Group Pool and the company's participation percentage in the pool.

PricewaterhouseCoopers LLP, under contract with the Massachusetts Division of Insurance, reviewed the adequacy of the company's loss reserves and loss adjustment expense reserves, as a function of its participation in the pool. The results of the firm's work were reported to the examiner-in-charge. As deemed appropriate, reference is made in this report to the actuarial firm's conclusion.

II. HISTORY AND PLAN OF OPERATION

Wausau General Insurance Company (hereinafter also "WGIC" and the "company") was incorporated in Illinois as the "Illinois Employers Insurance of Wausau" on October 10, 1972, and commenced business on November 29, 1972. The company was incorporated as a wholly owned subsidiary of Employers Mutual Liability Insurance Company of Wisconsin (subsequently renamed, "EMPLOYERS INSURANCE OF WAUSAU A Mutual Company" and later "Employers Insurance Company of Wausau"). Ownership of the company's issued and outstanding capital stock was transferred to Wausau Service Corporation, a holding corporation wholly owned by EMPLOYERS INSURANCE OF WAUSAU A Mutual Company effective January 1, 1978. The company changed its name to that presently used effective April 30, 1991.

On November 23, 1985, EMPLOYERS INSURANCE OF WAUSAU A Mutual Company (hereinafter also, "Employers") consummated an affiliation agreement with Nationwide Mutual Insurance Company (hereinafter also "NMIC") dated November 6, 1985. Nationwide Mutual's sister company, Nationwide Mutual Fire Insurance Company (hereinafter also "NMFIC"), was not party to the affiliation agreement. Within the context of this agreement, and certain subsequent agreements, NMIC exercised control of Employers and its subsidiaries through nomination of the various boards of directors, common executive management, and control of the reinsurance pool to which all direct premiums written by WGIC were ceded and from which all net premiums written were assumed. The directors of Employers continued to be elected by the policyholders of Employers, as required by s. 611.53 (2), Wis. Stat., but election and reelection of nominees associated with Nationwide Mutual on the Employers board preserved the affiliation.

The years of affiliation with NMIC resulted in considerable integration of the operations of Employers and Nationwide Mutual, together with their respective subsidiaries and affiliates. The two insurers and many of their respective insurance subsidiaries, including WGIC, pooled their risks, and shared a program of external reinsurance on the pooled risks. The same persons held many of the senior executive positions of NMIC and Employers. Employers and its subsidiaries and NMIC and its subsidiaries provided numerous services to one another. The

employees of Wausau Service Corporation received pension, medical, and other benefits from plans sponsored by Nationwide Mutual.

In 1998, Nationwide Mutual Insurance Company decided to end its affiliation with Employers in order to focus greater attention on personal lines, particularly on promotion and service to its "First of America" brand of life insurance and investment products. The management of Employers searched for an affiliation in replacement that would provide the company with a means of severing its ties with NMIC in an orderly manner that preserved the continuity of quality service to policyholders and claimants.

On October 5, 1998, Employers entered into an Affiliation and Contribution Note Purchase Agreement with Liberty Mutual Insurance Company (hereinafter also, "Liberty Mutual") and a De-Affiliation Master Agreement with NMIC. The affiliation with Liberty Mutual was approved by OCI, following a public hearing, on December 16, 1998, and, under the terms of the agreement, became effective January 1, 1999. The disaffiliation with NMIC was approved in writing on December 16, 1998, and, under the terms of that agreement, became effective December 31, 1998. As part of the affiliation, Liberty Mutual purchased Wausau Insurance Company (U.K.) Limited and Wausau Service Corporation, together with the latter's subsidiaries, including Wausau General Insurance Company.

WGIC redomiciled from Illinois to Wisconsin effective August 1, 1999.

As of December 31, 1999, the company's capitalization included \$2,000,000 in the form of 200,000 common shares (of 2,500,000 authorized) with a par value of \$10 per share, and \$37,000,000 of paid-in and contributed surplus. The following schedule reflects the activity in capital stock and paid-in surplus since the incorporation of the company:

| Year | Authorized Common Shares | Issued and Outstanding | Par Value Per Share | Gross Capital Paid Up | Paid-In and Contributed Surplus |
|------------|--------------------------------|------------------------------|---------------------------|--------------------------------|---------------------------------------|
| 1972 | 2,500,000 | 100,000 | \$10 | \$1,000,000 | \$ 1,500,000 |
| 1975 | | 100,000 | | 1,000,000 | (500,000) |
| 1979 | | | | | 4,000,000 |
| 1981 | | | | | 2,000,000 |
| 1982 | | | | | 4,000,000 |
| 1983 | | | | | 4,000,000 |
| 1984 | | | | | 4,000,000 |
| 1989 | | | | | 10,000,000 |
| 1996 | | | | | 8,000,000 |
| 12/31/1999 | <u>2,500,000</u> | <u>200,000</u> | <u>\$10</u> | <u>\$2,000,000</u> | <u>\$37,000,000</u> |

The company has no employees of its own. All day-to-day operations are conducted with staff provided by Wausau Service Corporation and Liberty Mutual in accordance with the business practices and internal controls of those organizations. Virtually all expenses are initially paid by Employers. Expenses other than federal income taxes are allocated on the basis of specific identification, utilization estimates, and time studies, in conformity with a general expense allocation agreement. Tax allocations are established in accordance with a written consolidated federal income tax policy applicable to Liberty Mutual and certain of its direct and indirect subsidiaries. Intercompany balances with affiliates are created in the ordinary course of business with settlements generally made on a quarterly basis. Written agreements with affiliates are further described in the section of this report titled "Affiliated Companies."

WGIC's operations are coordinated from the home offices of Employers in Wausau, Wisconsin. Statutory accounting services are provided by employees of Liberty Mutual in Boston, Massachusetts. Support services are provided from a network of claim, legal, and marketing offices located throughout the United States.

In 1999, the company wrote business in six of the nine jurisdictions in which it is licensed in the United States, as well as in various foreign countries and territories. The distribution of direct premiums written in 1999 by state or other jurisdictions was as follows:

| | | |
|-------------|---------------------|---------------|
| Wisconsin | \$13,762,579 | 87.3% |
| Tennessee | 768,911 | 4.9 |
| Illinois | 513,223 | 3.3 |
| New York | 411,310 | 2.6 |
| Georgia | 306,125 | 1.9 |
| Ohio | 135 | 0.0 |
| Other Alien | <u>3,114</u> | <u>0.0</u> |
| Total | <u>\$15,765,398</u> | <u>100.0%</u> |

As of the examination date, the company was licensed in the following nine U.S.

states:

| | | |
|----------|---------------|-----------|
| Georgia | Massachusetts | Oregon |
| Illinois | New York | Tennessee |
| Kansas | Ohio | Wisconsin |

In the state of Wisconsin, the company is licensed to transact the following lines of business as defined by s. Ins 6.75 (2), Wis. Adm. Code:

- (a) Fire, Inland Marine, and Other Property
- (b) Ocean Marine
- (c) Disability
- (d) Liability and Incidental Medical Expense
- (e) Automobile and Aircraft
- (f) Fidelity
- (g) Surety
- (j) Credit
- (k) Worker's Compensation
- (l) Legal Expense
- (n) Miscellaneous

The following table is a comparative summary of direct premiums written in 1996 and 1999, respectively:

| Line of Business | 1996 Premium | 1996 Percent | 1999 Premium | 1999 Percent | Percent Change in Premium |
|------------------------------|-----------------|-----------------|-----------------|-----------------|---------------------------------|
| Fire | \$ 67,781 | 0.2% | \$ 35,148 | 0.2% | (48.1)% |
| Allied lines | 51,984 | 0.2 | 28,315 | 0.2 | (45.5) |
| Commercial multiple peril | 98,655 | 0.3 | 17,838 | 0.1 | (81.9) |
| Inland marine | 2,516 | NM | 22,306 | 0.1 | 786.6 |
| Earthquake | 5,955 | NM | 3,772 | NM | (36.7) |
| Worker's compensation | 29,663,105 | 99.3 | 15,607,171 | 99.1 | (47.4) |
| Other liability - occurrence | 0 | NM | 33,833 | 0.2 | N/A |

| | | | | | |
|---------------------------------|---------------------|---------------|---------------------|---------------|----------------|
| Products liability - occurrence | 0 | NM | 1,106 | NM | N/A |
| Commercial auto liability | 1,943 | NM | 0 | 0.0 | (100.0) |
| Boiler and machinery | <u>19,512</u> | <u>NM</u> | <u>15,909</u> | <u>0.1</u> | <u>(18.5)</u> |
| Total All Lines | <u>\$29,911,451</u> | <u>100.0%</u> | <u>\$15,765,398</u> | <u>100.0%</u> | <u>(47.3)%</u> |

NM = Not meaningful

N/A = Not applicable

As of December 31, 1999, business was written through a sales force consisting of 146 account representatives and 2,577 independent agents.

Account representatives were employees of Wausau Service Corporation. Each received a salary, with the opportunity to earn a bonus, if remuneration credits, tallied much the same as commissions, exceed salary and chargeable business expenses. If remuneration credits did not exceed salary and chargeable expenses, there was no chargeback, nor was the deficiency carried into the following year's compensation formula.

During 2000, account representatives ceased to produce business for the Wausau Insurance Companies and began to place business with Liberty Mutual Insurance Company and certain of its subsidiaries instead. The Wausau Insurance Companies were reconfigured to market business exclusively through independent agents.

Independent agents are compensated according to the following commission schedule. Some rates are on a sliding scale that declines with the volume of premium or service revenue related to a specific policy.

| Product Line | Commission Rates |
|-----------------------------------|------------------|
| Worker's Compensation | 5% |
| General Liability | 15% |
| Auto | 15% |
| Umbrella | 15% |
| Packages | 17% |
| Other Liability | Varies |
| Other Property | 15% |
| Highly Protected Risks/ Property | |
| Special Risks | 15% |
| Fidelity, Burglary, & Other Crime | 15% |
| Plate Glass | 10% |
| Contract Surety Bonds | 5% to 30% |
| Other Surety Bonds | 25% |

III. MANAGEMENT AND CONTROL

Control by Succession of Parent Corporations

Liberty Mutual holds ultimate control of the company's board and of its executive direction. As more thoroughly described both previously and in Section IV of this report, all issued and outstanding common shares of the company are indirectly, but wholly, owned by Liberty Mutual. Liberty Mutual acquired Wausau Service Corporation and certain subsidiaries, including WGIC, pursuant to a Stock Purchase Agreement that was part of the affiliation arrangement with Employers.

Board of Directors

The board of directors consists of eight members. Directors are elected for three-year terms and are divided into three classes of expiry which are at, or as nearly possible at, one-third of the membership of the board. Members of the company's board of directors are typically members of other boards of directors in the holding company system. Officers are elected at the board's annual organizational meeting and as positions are created or fall vacant.

Directors who are members of executive management within the Liberty Mutual Group collect no compensation specific to their service on any board. Dwight E. Davis, the only director who is not currently a member of executive management, receives an annual stipend of \$10,000 per year, \$1,000 per year for service on each board committee, and \$1,250 for each regular or special meeting attended. This stipend compensates Mr. Davis for service on the following boards of directors: EMPLOYERS INSURANCE OF WAUSAU A Mutual Company, Wausau Business Insurance Company; Wausau General Insurance Company; and Wausau Underwriters Insurance Company. The stipend for attendance at meetings is calculated as if board meetings take place on a combined basis.

At the examination date, the board of directors consisted of the following persons:

| Name and Residence | Principal Occupation | Term Expiry |
|---|--|--------------------|
| J. Paul Condrin III Walpole, Massachusetts | Senior Vice President and Chief Financial Officer Liberty Mutual Insurance Company | 2001 |
| Terry L. Conner Rye, New Hampshire | Senior Vice President and Chief Information Officer Liberty Mutual Insurance Company | 2002 |
| Dwight E. Davis Mosinee, Wisconsin | President* Greenheck Fan Corporation | 2002 |
| A. Alexander Fontanes Duxbury, Massachusetts | Senior Vice President and Chief Investment Officer Liberty Mutual Insurance Company | 2002 |
| Gary R. Gregg Milton, Massachusetts | Executive Vice President Liberty Mutual Insurance Company | 2003 |
| Edmund F. Kelly Weston, Massachusetts | President and Chief Executive Officer Liberty Mutual Insurance Company | 2001 |
| Christopher C. Mansfield Dedham, Massachusetts | Senior Vice President and General Counsel Liberty Mutual Insurance Company | 2003 |
| James J. McIntyre Wausau, Wisconsin | President and Chief Operating Officer EMPLOYERS INSURANCE OF WAUSAU A Mutual Company | 2001 |

* Mr. Davis was formerly President and Chief Operating Officer of EMPLOYERS INSURANCE OF WAUSAU A Mutual Company

Committees of the Board

Article IV of the company's bylaws permits the appointment of executive, nominating, investment, and audit committees, and allows the formation of such other committees as the board may desire. At the time of this examination, the board of directors appointed an audit committee and a compensation committee. Neither of the committees was active during the period under examination.

Audit Committee

The designation of an audit committee of not less than 3 directors is permitted by Article IV, Section 4, of the bylaws. The committee meets from time to time as necessary. It is the function of this committee to maintain direct lines of communication between the board of

directors and both the company's independent public accounting firm, and the internal audit department. The committee makes recommendations to the full board on the appointment of public accountants; reviews the financial statements of the company, its subsidiaries, and affiliates; inquires into the effectiveness of the company's internal auditing methods and procedures; and makes reports concerning its activities to the full board. Membership of the audit committee at the examination date was as follows: J. Paul Condrin III (Chairman), A. Alexander Fontanes, and Christopher C. Mansfield.

Compensation Committee

The compensation committee meets from time to time as its responsibilities may require; during the examination period. It is the function of this committee to research and issue recommendations to the board as a whole concerning director and senior executive compensation. Oversight is also extended to matters affecting retirement programs and employee benefit plans, succession plans, and personnel matters relating to high-level executives. Membership of the salary and compensation committee at the examination date was as follows: Edmund F. Kelly (Chairman), Gary R. Gregg, and James J. McIntyre.

Officers of the Company

The officers serving at the time of this examination are listed below.

| Name | Office | 1999 Compensation | |
|----------------------|---|-------------------|-------------|
| | | Salary | Bonus |
| Edmund F. Kelly | Chairman of the Board and Chief Executive Officer | \$950,000 | \$1,500,000 |
| Gary R. Gregg | Vice Chairman | 525,000 | 181,000 |
| James J. McIntyre | President and Chief Operating Officer | 225,000 | 81,000 |
| J. Stanley Hoffert | Vice President, General Counsel, and Secretary | 224,000 | 66,000 |
| Elliot J. Williams | Vice President and Treasurer | 190,000 | 49,000 |
| Robert D. Effinger | Senior Vice President and Chief Actuary | 155,000 | 0 |
| Harold W. Larson | Senior Vice President, Custom Accounts Marketing | 137,000 | 32,000 |
| Edward W. Hancock | Vice President and Director, International Operations | 140,000 | 45,000 |
| Gary J. Ostrow | Vice President, Corporate Taxation | 200,000 | 0 |
| W. Craig Olafsson | Assistant Secretary | 120,000 | 17,000 |
| James Pugh | Assistant Secretary | 108,000 | 0 |
| Lawrence H. S. Yahia | Assistant Secretary | 200,000 | 100,000 |
| Richard Cloran | Assistant Treasurer | 123,000 | 61,000 |
| Lynn A. Theilig | Assistant Secretary | 61,000 | 0 |

IV. AFFILIATED COMPANIES

Wausau General Insurance Company is a member of the Liberty Mutual Group, a multinational holding company system under the dual control of Liberty Mutual Insurance Company (Liberty Mutual) and Liberty Mutual Fire Insurance Company (LMFIC). A chart of the companies within the holding company system is presented later in this section of the examination report.

WGIC is part of a distinct holding company subsystem within the Liberty Mutual Group, commonly known as the Wausau Insurance Companies. The Wausau Insurance Companies' marketing emphasis is on middle market and small business commercial risks solicited through independent agents. EMPLOYERS INSURANCE OF WAUSAU A Mutual Company exercises a leadership role within the Wausau Insurance Companies holding company subsystem. Employers does not own any subsidiaries, nor does it exercise "control" of any affiliate as that term is defined by s. 601.01(13), Wis. Stat. Its leadership role exists by virtue of its position as the largest member of that holding company subsystem. As of December 31, 1999, the Wausau Insurance Companies consisted of 25 entities, including 6 property and casualty insurers, 2 health maintenance organizations, 13 insurance brokerages or agencies, 3 providers of ancillary insurance services, and a holding company.

Present Succession of Control

WGIC is a third-tier affiliate of Liberty Mutual. Each entity in the immediate succession of control is described below, beginning with the ultimate parent and progressing to the next immediate tier of control.

Liberty Mutual Insurance Company

Liberty Mutual Insurance Company was incorporated under the laws of the Commonwealth of Massachusetts on January 1, 1912, and commenced business on July 1, 1912. The incorporator was Liberty Mutual Fire Insurance Company, which advanced all of the organizational expenses and initial financing.

Liberty Mutual is a diversified property and casualty insurer of commercial and personal lines, with distribution primarily by independent agents who confine their representation

exclusively to companies in the Liberty Mutual Group. The company is licensed in all 50 U.S. states, the District of Columbia, Puerto Rico, the U.S. Virgin Islands, Canada, and in various other foreign countries. Headquarters are maintained in Boston, Massachusetts.

As of December 31, 1999, Liberty Mutual reported assets of \$19,879,383,812, liabilities of \$14,329,938,118, policyholders' surplus of \$5,549,445,693, and net income of \$173,094,256. Liberty Mutual was examined concurrently with WGIC as of December 31, 1999, and the results of that examination were expressed in a separate report issued by the Massachusetts Division of Insurance.

Wausau Service Corporation

Wausau Service Corporation was incorporated under the laws of the state of Wisconsin as the "Wausau Insurance Finance Corporation" on September 21, 1959. It was initially organized to finance insurance premiums, a function that had been handled through the Insurance Finance Company, an independently owned corporation. Within only a few years, with the introduction of company installment plans, the corporation's original purpose became largely obsolete. From 1964 to the formation of Countrywide Services Corporation in 1971, WSC provided loss adjustment, safety, and health services to self-insured accounts on behalf of the Wausau Insurance Companies. Thereafter, for a time, the corporation essentially fell dormant. Then, in late 1977, it was decided to reactivate WSC as a downstream holding company. On November 18, 1977, WSC's board of directors voted to accept transfer of ownership from EMPLOYERS INSURANCE OF WAUSAU A Mutual Company (then known as Employers Mutual Liability Insurance Company of Wisconsin) of the capital stock of all affiliates except Wausau Insurance Company (U.K.) Limited (then known as Employers of Wausau (U.K.) Ltd.) effective January 2, 1978. On December 31, 1998, pursuant to a Stock Purchase Agreement dated October 5, 1998, Wausau Service Corporation, together with certain of its subsidiaries, was sold to Liberty Mutual.

As of December 31, 1999, the corporation reported assets of \$226,708,000, liabilities of \$39,937,000, stockholders' equity of \$186,771,000, and a net income of \$1,383,000.

Written Agreements with Affiliates

As previously noted, WGIC has no employees of its own. All operations are conducted by employees of WSC and Liberty Mutual, in accordance with the business practices and internal controls of those organizations. In addition to ongoing common management and control by these upstream affiliates, various written agreements and undertakings affect the company's relationship to its affiliates. Reinsurance agreements are described in the reinsurance section of this report. A brief summary of the other agreements follows:

Liberty Mutual Insurance Company

Management Agreement

WGIC and Liberty Mutual entered into a Management Agreement effective January 1, 2000. Under this agreement, Liberty Mutual is to provide all services essential to the day-to-day operation of WGIC as requested by WGIC. WGIC is to reimburse Liberty Mutual a percentage of the total reasonable expenses, costs, losses, and disbursements, excluding claim payments, incurred by Liberty Mutual in its operation and in the operation of its subsidiaries. This allocation percentage is to be consistent with WGIC's customary cost allocation practices and is to be supported by WGIC's current expense allocation model, which model substantially complies with statutory accounting guidelines promulgated by the National Association of Insurance Commissioners. Settlements of fees and expenses are to be made within 45 days of the end of each calendar quarter.

Either party may terminate this agreement at any time with 90 days' written notice to the other. Only 45 days' notice is required in the event of the insolvency of either party. Liberty Mutual may terminate the contract immediately if WGIC fails to make payment of fees and expenses and such failure has not been cured within 30 days after the due date, or if WGIC's participation in the Liberty Mutual Group Pool is terminated and WGIC is no longer affiliated with the Liberty Mutual Group. In the event of termination, Liberty Mutual shall continue to provide such services for a period of time that is reasonably necessary to transfer service responsibilities to a new party.

Reciprocal Claims Service Agreement

Effective February 14, 2000, WGIC entered into a Reciprocal Claims Service Agreement with Liberty Mutual and other members of the Liberty Mutual Group to facilitate a combination of surety and fidelity claim operations under the control of Liberty Mutual. Under this agreement, Liberty Bond Services, a division of Liberty Mutual directs and supervises the fidelity and surety claim operations of all parties to the agreement. Each party appoints the others as its authorized agent, and grants each such party authority to act in its name and in its stead with respect to fidelity and surety claims. Each such party shall serve as the trustee and fiduciary of the others in servicing claims under the agreement. All parties agree to keep parties to this agreement fully advised of work performed on behalf of the others pursuant to reporting guidelines established by Liberty Bond Services. Each party to the agreement continues to remain responsible for payment of their own unallocated loss adjustment expenses. Allocated loss adjustment expenses and loss expenses incurred remain the responsibility of the party that underwrote the bond or policy. Parties to the agreement agree to preserve the confidentiality of information to which they receive access under this agreement and agree to use such information solely as directed by Liberty Bond Services for the performance of this agreement.

Tax Sharing Policy Memorandum

The Liberty Mutual Group had a tax sharing policy memorandum dated July 30, 1990. The principal elements within this tax policy memorandum may be summarized as follows:

- Beginning with the 1989 tax year, each company in the Liberty Mutual Group is to compute its taxes as if it were a stand-alone entity.
- Each entity will be reimbursed for net operating losses, capital losses, and tax credits if and when and only to the extent that they are used by the consolidated group. Credit will not be given for net operating losses, capital losses, and tax credits that expire unutilized on a separate company basis.
- Tax rates used in computing the separate company tax liability are the regular corporate rates for the regular, capital gains, alternative minimum, and environmental tax in effect at the

time the income is earned or, in the case of carryovers or carrybacks, at the rates in effect for the period in which the income against which the tax attribute is used was earned.

- Interest and penalties assessed against the Liberty Mutual Group as a result of a state or IRS audit will be assessed to the separate company from which the adjustment came.
- Each entity is to be provided a statement of the amount it is due or the amount owed within 45 days of the date of filing the consolidated return. Payments of amounts owed are due within 30 days' following receipt of the statement of balances. Late payments will carry an interest charge at the federal rate on tax deficiencies from the date of the original billing.

Wausau Service Corporation

WGIC entered into a Management Agreement with Wausau Service Corporation effective December 31, 1998, which was amended effective January 1, 2000. The terms of this agreement are largely the same as those of the Management Agreement with Liberty Mutual. This agreement was amended to terminate the exclusivity of Wausau Service Corporation's appointment as a provider of management services. The employees that provide services to the Wausau Insurance Companies are in the midst of a comprehensive reorganization to integrate them into the Liberty Mutual Group, and thereby eliminate the duplication of services and take advantage of the respective organizations' strengths. The employees of Wausau Service Corporation that are anticipated to remain after the reorganization are gradually being reassigned to Liberty Mutual. Eventually, Wausau Service Corporation will not have any employees. Provisions for the curtailment and addition of services were added to the agreement to facilitate this transition. In the event of any conflict or inconsistency between the provisions of the management agreement with Liberty Mutual and the management agreement with Wausau Service Corporation, the conflict or inconsistency will be resolved in favor of the provisions of the contract with Liberty Mutual.

Liberty Mutual Investment Advisors LLC

Cash Management Agreement

WGIC entered into a Cash Management Agreement with Liberty Mutual Investment Advisors LLC dated January 28, 2000. Under this agreement, Liberty Mutual Investment

Advisors LLC manages an investment pool on behalf of participating members of the Liberty Mutual Group, investing and reinvesting funds contributed by the members in short-term obligations of banks, corporations, and the U.S. and Canadian federal governments with a maximum duration of 365 days from the date of purchase. The investment pool functions in a manner analogous to a short-term bond mutual fund. A participant may terminate the agreement at the end of any business day upon prior written notice to the manager, or at any time by Liberty Mutual Investment Advisors LLC upon 30 days' written notice to the company. If the company should ever become insolvent, the company's statutory successor in interest could withdraw all or any portion of the company's proportionate share of the assets in the investment pool.

Investment Management Agreement

Effective May 1, 2000, WGIC entered into an investment management agreement with Liberty Mutual Investment Advisors LLC. Under this agreement, Liberty Mutual Investment Advisors LLC is to act as the company's agent and attorney-in-fact with respect to its investment portfolio. Subject to the WGIC's board of directors and investment guidelines, Liberty Mutual Investment Advisors LLC has complete day-to-day discretionary control, including the power to make acquisitions and disposals of investments, and issue instructions to brokers and custodians. Liberty Mutual Investment Advisors LLC is to be reimbursed for all custody related charges and wire transfer fees related to the account, including, but not limited to, commission expenses and transaction fees imposed by the U.S. Securities and Exchange Commission. Liberty Mutual Investment Advisors LLC is to receive a monthly management fee equivalent to 3.4 basis points on an annualized basis. In the event that compensation is determined to be unfair and unreasonable in relation to actual expenses incurred in managing the account, the amount of compensation will be adjusted by mutual agreement.

The agreement is to be construed in accordance with applicable federal law and, to the extent not preempted, the laws of the State of Wisconsin. Liberty Mutual Investment Advisors LLC may terminate this agreement at any time upon 90 days' advance written notice. WGIC may terminate this agreement at any time upon written notice to Liberty Mutual Investment Advisors

LLC, but Liberty Mutual Investment Advisors LLC shall have a reasonable time, not to exceed 90 days, to transfer assets to a custodian selected by Employers.

Liberty Mutual Capital Corporation

WGIC, together with its affiliates, Employers, Wausau Service Corporation, Wausau Business Insurance Company, and Wausau Underwriters Insurance Company, entered into a Revolving Loan Agreement with Liberty Mutual Capital Corporation as of December 31, 1998. Under this agreement, Liberty Mutual Capital Corporation agrees to provide Employers and its specified affiliates, collectively, with a line of credit of up to \$50,000,000. Loans under the agreement must be in a minimum principal amount of \$25,000 and in integral multiples of \$25,000, as the borrowers may specify, up to but not exceeding the \$50,000,000 aggregate line of credit. The current balances of loans to each borrower are to be evidenced by a single note from each borrower. The obligations of each borrower are several and not joint, that is, each borrower is solely responsible for its own loan balance and related obligations and not those of any other borrower utilizing the aggregate line of credit. The rate of interest is based on the short-term funding facilities of Liberty Mutual and Liberty Mutual Capital Corporation, but in no event to exceed the average prime rate published from time to time in the Wall Street Journal plus 5% per annum.

Wausau Insurance Companies

Expense Allocation Agreement

WGIC entered into an expense allocation agreement with Employers and its other affiliates effective January 1, 1992. These companies share various administrative services, office facilities, and equipment, with expenses being apportioned among the applicable member/user companies.

Temporary Help Agencies Producer Agreement

The members of the Wausau Insurance Companies are party to a Temporary Help Agencies Producer Agreement among themselves and with Yunker Innovative Options, Inc. effective August 1, 1996, to provide temporary help service for the placement of certain insurance

business produced by Yunker Innovative Options, Inc. and agencies affiliated with the Wausau Insurance Companies.



V. REINSURANCE

The company participates in a pooling arrangement with certain of its affiliates. The pool participants cede 100% of their net premiums written, losses, loss adjustment expenses, and underwriting expenses to Liberty Mutual Insurance Company. Liberty Mutual, as the lead company and pool manager, administers all aspects of the pooled business, including placement of reinsurance with nonaffiliated insurers. The net pooled business is then distributed according to the participations listed below. Income and expenses related to investment operations and corporate taxes, including federal income taxes, are not included in pooling.

WGIC cedes premiums to certain affiliated and nonaffiliated insurers before pooling, so that the pool is insulated from exposure on certain risks. WGIC assumes premiums from certain affiliated and nonaffiliated insurers before pooling, so that the pool thereby assumes certain other risks. In addition to reinsurance that WGIC assumes and cedes for its own account prior to pooling, WGIC receives protection from the reinsurance that Liberty Mutual obtains on behalf of the Liberty Mutual Pool.

All voluntary contracts reviewed by examiners contained proper insolvency provisions. Involuntary arrangements, such as state auto insurance facilities, mine subsidence funds, and other involuntary excess funds have provisions deemed appropriate by the governmental authorities that establish and administer them. Significant treaties are summarized as follows.

Affiliated Pooling Agreement

Participations:

| | 1/1/99 | 1/1/00 |
|---|---------------|---------------|
| Liberty Mutual Insurance Company | 65.95% | 63.00% |
| EMPLOYERS INSURANCE OF WAUSAU | | |
| A Mutual Company | 13.00% | 16.00% |
| Liberty Mutual Fire Insurance Company | 10.00% | 10.00% |
| Liberty Insurance Corporation | 6.00% | 6.00% |
| Golden Eagle Insurance Corporation | 2.50% | 2.50% |
| Montgomery Mutual Insurance Company | 0.70% | 0.70% |
| Wausau Business Insurance Company | 0.40% | 0.40% |
| Wausau General Insurance Company | 0.40% | 0.40% |
| Wausau Underwriters Insurance Company | 0.40% | 0.40% |
| Merchants and Business Men's Mutual Insurance Company | 0.25% | 0.20% |

| | | |
|---|-------|-------|
| LM Insurance Corporation | 0.20% | 0.20% |
| Montgomery Indemnity Company | 0.10% | 0.10% |
| The First Liberty Insurance Corporation | 0.10% | 0.10% |

100% Quota Share Affiliated Companies:

| | | |
|---|-------|-------|
| Liberty Lloyds of Texas Insurance Company | 0.00% | 0.00% |
| Liberty Insurance Company of America | 0.00% | 0.00% |
| Liberty Personal Insurance Company | 0.00% | 0.00% |
| Liberty Surplus Insurance Corporation | 0.00% | 0.00% |
| Liberty Insurance Underwriters, Inc. | 0.00% | 0.00% |
| Colorado Casualty Insurance Company | 0.00% | 0.00% |
| Bridgefield Employers Insurance Company | 0.00% | 0.00% |
| Bridgefield Casualty Insurance Company | 0.00% | 0.00% |

| | | |
|---------------------------------|---------|---------|
| Total Liberty Mutual Group Pool | 100.00% | 100.00% |
|---------------------------------|---------|---------|

| | |
|----------------------|--|
| Lines Covered: | All |
| Items Included: | Losses, loss adjustment expenses, underwriting expenses, salvage and subrogation recoveries, assessments, taxes, and policyholder dividends |
| Effective: | January 1, 1999, as amended effective January 1, 2000 |
| Termination: | At any time with 120 days' written notice by any party. Each participant shall remain liable with respect to all cessions in force on the effective date of termination. |
| Additional Comments: | Any dispute arising out of this agreement shall be settled through arbitration. Canadian business participations are limited to Liberty Mutual Insurance Company and Liberty Mutual Fire Insurance Company, which have 90% and 10% participation, respectively. |

Other Ceding Reinsurance

The company is a direct co-party to the following ceded reinsurance agreements, which have been summarized in detail in the concurrent examination report of EMPLOYERS INSURANCE OF WAUSAU A Mutual Company.

| Type of Reinsurance | Effective Date | Termination Date |
|---|----------------|------------------|
| <u>Pre-Pool Reinsurance Program</u> | | |
| 100% Quota Share on Discontinued Operations with Nationwide Indemnity Company | 12/31/1998 | Continuous |
| Commercial Insurance Group Property Underlying Per Risk Excess of Loss Reinsurance Contract | 09/01/1999 | 09/01/2000 |
| Property Automatic Facultative Reinsurance Agreement | 07/01/1999 | Continuous |

| Type of Reinsurance | Effective Date | Termination Date |
|--|-----------------------|-------------------------|
| <u>Pre-Pool Reinsurance Program (continued)</u> | | |
| Special Surplus Reinsurance Contract | 01/01/1998 | 01/01/1999 |
| Three-Layer Property Per Risk Excess of Loss | 07/01/1999 | 07/01/2000 |
| Four-Layer Property Catastrophe Excess of Loss | 07/01/1999 | 07/01/2000 |
| Highly Protected Risk/Property Special Risk Aggregate Excess of Loss | 01/01/1999 | 01/01/2001 |
| Two-Layer Casualty Buffer Agreement | 07/01/1999 | 07/01/2000 |
| Four-Layer Casualty Excess of Loss | 07/01/1999 | 07/01/2000 |
| Worker's Compensation per Claimant Excess of Loss Agreement | 07/01/1999 | 07/01/2000 |
| Three-Layer Worker's Compensation Excess of Loss | 07/01/1999 | 07/01/2000 |
| Employment Related Practices Liability Quota Share | 04/01/1999 | 04/01/2000 |
| Commercial Umbrella Liability First Excess of Loss | 01/01/1985 | Continuous |
| Commercial Umbrella Liability Second Excess of Loss | 08/15/1990 | Continuous |
| <u>Liberty Mutual Pool Reinsurance Program</u> | | |
| Three-Layer Property Catastrophe Excess of Loss | 01/01/1999 | 01/01/2000 |
| Underlying Property Per Risk Excess of Loss | 01/01/1999 | 01/01/2000 |
| Three-Layer Property Per Risk Excess of Loss | 01/01/1999 | 01/01/2000 |
| Four-Layer Casualty Excess of Loss | 01/01/1999 | 01/01/2000 |
| Workers' Compensation Excess of Loss | 01/01/1999 | 01/01/2000 |
| Two-Layer Workers' Compensation Catastrophe Excess of Loss | 01/01/1999 | 01/01/2000 |
| Truck Casualty Automatic Excess of Loss | 07/01/1999 | 07/01/2000 |

VI. FINANCIAL DATA

The following financial statements reflect the financial condition of the company as reported in the December 31, 1999, annual statement to the Commissioner of Insurance. Adjustments made as a result of the examination are noted in the section of this report captioned "Reconciliation of Policyholders' Surplus." Also included in this section are schedules which reflect the financial experience of the company, the compulsory and security surplus calculation, and NAIC Insurance Regulatory Information System (IRIS) ratio results for the period under examination.

Wausau General Insurance Company
Assets
As of December 31, 1999

| | Ledger Assets | Nonledger Assets | Nonadmitted Assets | Admitted Assets |
|---|-----------------------------|-----------------------------|-------------------------------|-----------------------------|
| Bonds | \$98,298,323 | | \$ 15,995 | \$98,282,328 |
| Cash | (386,807) | | | (386,807) |
| Short-term investments | 6,036,113 | | | 6,036,113 |
| Receivable for securities | 8,875 | | | 8,875 |
| Write-ins for invested assets: | | | | |
| 1994 private passenger auto escrow amounts – 2/1/94 | 17,084 | | | 17,084 |
| December 1996 private passenger auto filing escrow accounts | 3,536 | | | 3,536 |
| Agents' balances or uncollected premiums: | | | | |
| Premiums and agents' balances in course of collection | 3,496,735 | | 379,157 | 3,117,578 |
| Premiums, agents' balances, and installments booked but deferred and not yet due | 3,951,982 | | 31,000 | 3,920,982 |
| Accrued retrospective premiums | | \$2,445,524 | 247,622 | 2,197,902 |
| Bills receivable, taken for premiums | 380 | | 380 | |
| Reinsurance recoverables on loss and adjustment payments | 2,424,421 | | | 2,424,421 |
| Federal income tax recoverable and interest thereon | | 3,767,486 | | 3,767,486 |
| Guaranty funds receivable or on deposit | 11,161 | | | 11,161 |
| Interest, dividends, and real estate income due and accrued | | 1,712,351 | | 1,712,351 |
| Equities and deposits in pools and associations | 161,610 | | 11,809 | 149,801 |
| Amounts receivable relating to uninsured accident and health plans | 44,238 | 289 | 1,613 | 42,914 |
| Write-ins for other than invested assets | | | | |
| Amounts receivable under uninsured plans | 899,785 | | 39,630 | 860,155 |
| Other assets | 546,780 | | 283,696 | 263,084 |
| Total Assets | <u>\$115,514,216</u> | <u>\$7,925,650</u> | <u>\$1,010,902</u> | <u>\$122,428,964</u> |

Wausau General Insurance Company
Liabilities, Surplus, and Other Funds
As of December 31, 1999

| | |
|--|--------------------------|
| Losses | \$51,132,521 |
| Loss adjustment expenses | 10,453,508 |
| Contingent commissions and other similar charges | 24,904 |
| Other expenses (excluding taxes, licenses, and fees) | 941,212 |
| Taxes, licenses, and fees (excluding federal and foreign income taxes) | 183,311 |
| Unearned premiums | 9,081,101 |
| Dividends declared and unpaid: | |
| Policyholders | 151,071 |
| Funds held by company under reinsurance treaties | 129,219 |
| Amounts withheld or retained by company for the account of others | 543,589 |
| Provision for reinsurance | 467,662 |
| Drafts outstanding | 1,159,890 |
| Payable to parent, subsidiaries, and affiliates | 1,883,735 |
| Payable for securities | 186,978 |
| Write-ins for liabilities: | |
| Amounts held under uninsured plans | 1,058,658 |
| Other liabilities | 1,023,615 |
| 1994 private passenger auto escrow amounts – 2/1/94 | 17,084 |
| December 1996 private passenger auto filing escrow accounts | <u>3,536</u> |
| Total Liabilities | 78,441,594 |
| Common capital stock | 2,000,000 |
| Gross paid in and contributed surplus | 37,000,000 |
| Unassigned funds (surplus) | 4,987,370 |
| Surplus as Regards Policyholders | <u>43,987,370</u> |
| Total Liabilities, Surplus, and Other Funds | <u>\$122,428,964</u> |

Wausau General Insurance Company
Summary of Operations
For the Year 1999

Underwriting Income

| | |
|-----------------|--------------|
| Premiums earned | \$27,617,609 |
|-----------------|--------------|

Deductions

| | |
|--|------------------|
| Losses incurred | 20,709,836 |
| Loss expenses incurred | 4,696,888 |
| Other underwriting expenses incurred | 6,774,490 |
| Write-ins for underwriting deductions: | |
| Other underwriting deductions | <u>(125,971)</u> |

| | |
|-------------------------------|-------------------|
| Total underwriting deductions | <u>32,055,243</u> |
|-------------------------------|-------------------|

| | |
|-------------------------------|-------------|
| Net underwriting gain or loss | (4,437,634) |
|-------------------------------|-------------|

Investment Income

| | |
|--------------------------------------|------------------|
| Net investment income earned | 6,774,399 |
| Net realized capital gains or losses | <u>1,472,720</u> |
| Net investment gain or loss | 8,247,119 |

Other Income

| | |
|---|------------------|
| Net gain or loss from agents' or premium balances charged off | (148,038) |
| Finance and service charges not included in premiums | 159,543 |
| Write-ins for miscellaneous income: | |
| Miscellaneous income/expense | <u>(287,664)</u> |
| Total other income | <u>(276,159)</u> |

| | |
|---|----------------|
| Net income before dividends to policyholders and before federal and foreign income taxes | 3,533,326 |
| Dividends to policyholders | <u>463,753</u> |

| | |
|--|----------------|
| Net income after dividends to policyholders but before federal and foreign income taxes | 3,069,573 |
| Federal and foreign income taxes incurred | <u>704,774</u> |

| | |
|------------|---------------------|
| Net Income | <u>\$ 2,364,799</u> |
|------------|---------------------|

Wausau General Insurance Company
Cash Flow
For the Year 1999

| | | |
|--|--------------------|---------------------|
| Premiums collected net of reinsurance | \$32,784,461 | |
| Loss and loss adjustment expenses paid (net of salvage or subrogation) | (16,805,448) | |
| Underwriting expenses paid | 7,162,660 | |
| Other underwriting income/(expenses) | <u>185,495</u> | |
| Cash from underwriting | | \$42,612,744 |
| Net investment income | | 7,820,053 |
| Other income (expenses): | | |
| Agents' balances charged off | (148,038) | |
| Net amount withheld or retained for account of others | (2,114,217) | |
| Write-ins for miscellaneous items: | | |
| Other income/expense | <u>50,971</u> | |
| Total other income | | <u>(2,211,284)</u> |
| Deduct: | | |
| Dividends to policyholders paid | 375,001 | |
| Federal income taxes (paid) recovered | <u>(1,165,940)</u> | |
| Net cash from operations | | 46,680,572 |
| Proceeds from investments sold, matured, or repaid: | | |
| Bonds | <u>47,048,188</u> | |
| Total investment proceeds | | 47,048,188 |
| Cost of investments acquired (long-term only): | | |
| Bonds | <u>41,913,006</u> | |
| Total investments acquired | | <u>41,913,006</u> |
| Net cash from investments | | 5,135,182 |
| Cash applied for financing and miscellaneous uses: | | |
| Net transfers to affiliates | 68,362,954 | |
| Other applications | <u>1,307,113</u> | |
| Total | | 69,670,067 |
| Net cash from financing and miscellaneous sources | | <u>(69,670,067)</u> |
| Net change in cash and short-term investments | | (17,854,313) |
| Reconciliation: | | |
| Cash and short-term investments, January 1, 1999 | | <u>23,503,619</u> |
| Cash and short-term investments, December 31, 1999 | | <u>\$ 5,649,306</u> |

Wausau General Insurance Company
Compulsory and Security Surplus Calculation
December 31, 1999

| | | | |
|---|------------|-------------------|---------------------|
| Assets | | \$122,428,964 | |
| Less investment in insurance subsidiaries not in excess of subsidiaries' security surplus | | -0- | |
| Less net examination adjustments* | | 2,910,733 | |
| Less liabilities | | <u>78,441,594</u> | |
| Adjusted surplus | | | \$41,076,637 |
| Annual premium: | | | |
| Individual accident and health | \$ 268,334 | | |
| Factor | <u>15%</u> | | |
| Total | | | 40,250 |
| Group accident and health | 1,602,548 | | |
| Factor | <u>10%</u> | | |
| Total | | | 160,255 |
| All other insurance | 31,231,826 | | |
| Factor | <u>20%</u> | | |
| Total | | <u>6,246,365</u> | |
| Compulsory surplus (subject to a minimum of \$2 million) | | | <u>6,446,870</u> |
| Compulsory surplus excess (or deficit) | | | <u>\$34,629,767</u> |
| Adjusted surplus | | | 41,076,637 |
| Security surplus: | | | |
| (140% of compulsory surplus, factor reduced 1% for each \$33 million in premium written in excess of \$10 million with a minimum of 110%) | | | <u>9,025,618</u> |
| Security surplus excess (or deficit) | | | <u>\$32,051,019</u> |

* These consist of the adjustments of the examination report as shown under the caption "Reconciliation of Policyholders' Surplus." Accordingly, the compulsory and security surplus excesses reflected in this schedule differ from the figures reported by the company in its supplementary filing with the 1999 annual statement.

Wausau General Insurance Company
Reconciliation and Analysis of Surplus as Regards Policyholders
For the Three-Year Period Ending December 31, 1999

The following schedule is a reconciliation of total surplus during the period under examination as reported by the company in its filed annual statements:

| | 1997 | 1998 | 1999 |
|--|---------------------|---------------------|---------------------|
| Surplus, beginning of year | \$28,419,212 | \$31,703,213 | \$41,994,004 |
| Net income | 3,662,425 | 7,591,632 | 2,364,799 |
| Net unrealized capital gains or (losses) | (1,900) | 4,394 | (15,995) |
| Change in nonadmitted assets | (14,535) | 160,731 | (458,167) |
| Change in provision for reinsurance | 15,431 | 1,801,065 | 44,407 |
| Change in excess of statutory reserves over statement reserves | (198,000) | 188,000 | 11,000 |
| Write-ins for gains and losses in surplus: | | | |
| Discontinued business surplus adjustment | (86,062) | (90,710) | 0 |
| Accounts payable | (93,358) | 635,679 | 0 |
| Other surplus items | 0 | 0 | 48,282 |
| Change in accumulated translation adjustment | <u>0</u> | <u>0</u> | <u>(960)</u> |
| Change in surplus as regards Policyholders for the year | <u>3,284,001</u> | <u>10,290,791</u> | <u>1,993,366</u> |
| Surplus, end of year | <u>\$31,703,213</u> | <u>\$41,994,004</u> | <u>\$43,987,370</u> |

Insurance Regulatory Information System
For the Three-Year Period Ending December 31, 1999

The following is a summary of NAIC Insurance Regulatory Information System (IRIS) results for the period under examination. Exceptional ratios are denoted with asterisks. A discussion of the exceptional ratios may be found after the IRIS ratios.

| Ratio | 1997 | 1998 | 1999 |
|---|-------------|-------------|-------------|
| #1 Gross Premium to Surplus | 284% | 160% | 114% |
| #1A Net Premium to Surplus | 205 | 99 | 76 |
| #2 Change in Net Writings | (12) | (36)* | (20) |
| #3 Surplus Aid to Surplus | 0 | 0 | 0 |
| #4 Two-Year Overall Operating Ratio | 98 | 98 | 98 |
| #5 Investment Yield | 7.2 | 7.3 | 6.0 |
| #6 Change in Surplus | 11 | 18 | 7 |
| #7 Liabilities to Liquid Assets | 86 | 74 | 71 |
| #8 Agents' Balances to Surplus | 7 | 3 | 6 |
| #9 One-Year Reserve Development to Surplus | (3) | (11) | (1) |
| #10 Two-Year Reserve Development to Surplus | 1 | (13) | (5) |
| #11 Estimated Current Reserve Deficiency to Surplus | 8 | 136* | (89) |

The exceptional values for Ratio #2, "Change in Net Writings," and Ratio #11 in 1998 of (36)% and 136%, respectively, were caused by the company's withdrawal from the Nationwide Insurance Enterprise's reinsurance pool on December 31, 1998. For a brief moment in time coinciding with the close of business on December 31, 1998, the company was not a participant in a reinsurance pool. The result for Ratio #2 reflects the fact that, as a participant in Nationwide Insurance Enterprise's reinsurance pool, the company had higher writings leverage on a net basis than on a direct basis. The year-to-year comparisons inherent in the calculation of Ratio #11 were distorted by depooling.

Financial Experience of Wausau General Insurance Company

| Year | Direct Premiums Written | Net Premiums Written | Premiums Earned | Loss and LAE Ratio | Expense Ratio | Combined Ratio |
|-------------|--|-------------------------------------|----------------------------|-----------------------------------|--------------------------|---------------------------|
| 1995 | \$24,130,911 | \$30,570,626 | \$30,121,866 | 86.4% | 27.1% | 113.5% |
| 1996 | 29,911,451 | 73,490,308 | 63,261,612 | 86.0 | 25.7 | 111.7 |
| 1997 | 24,684,206 | 64,866,487 | 63,877,581 | 77.6 | 27.5 | 105.1 |
| 1998 | 20,167,986 | 41,714,155 | 61,228,533 | 83.8 | 34.3 | 118.1 |
| 1999 | 15,765,398 | 33,556,461 | 27,617,609 | 92.0 | 20.6 | 112.6 |

| Year | Admitted Assets | Liabilities | Surplus As Regards Policyholders | Net Income |
|-------------|----------------------------|--------------------|---|-----------------------|
| 1995 | \$ 85,068,197 | \$ 57,870,374 | \$27,197,823 | \$1,107,078 |
| 1996 | 145,041,844 | 116,622,632 | 28,419,212 | (6,047,039) |
| 1997 | 147,124,151 | 115,420,938 | 31,703,213 | 3,662,425 |
| 1998 | 139,157,813 | 97,163,809 | 41,994,004 | 7,591,632 |
| 1999 | 122,428,964 | 78,441,594 | 43,987,370 | 2,364,799 |

The foregoing charts, summarizing the company's financial experience in recent years, correctly suggest that the company underwent a major change during 1996. Effective January 1, 1996, the company's participation in the Nationwide reinsurance pool increased from 0.6% to 2.1%. The pool readjustments led to notable increases in gross premiums written, net premiums written, premiums earned, admitted assets, and liabilities. The net loss of 1996 was occasioned in large part by catastrophic property losses precipitated by Hurricane Fran. The effect that these losses would have had on surplus was partially offset by a parental contribution of \$8,000,000 to gross paid-in and contributed surplus.

The company underwent another major change in 1998 and 1999. Effective December 31, 1998, the company withdrew from the Nationwide Insurance Enterprise's reinsurance pool. As noted earlier, for a brief moment in time coinciding with the close of business on December 31, 1998, the company was not a participant in a reinsurance pool. Liabilities decreased because as a participant in Nationwide Insurance Enterprise's reinsurance pool the company had higher writings leverage on a net basis than on a direct basis. Effective January 1, 1999, WGIC joined the Liberty Mutual Group's reinsurance pool, but with a lower participation percentage than had been the case with Nationwide Insurance Enterprise's reinsurance pool.

Reconciliation of Policyholders' Surplus

The following schedule is a reconciliation of surplus as regards policyholders between that reported by the company and as determined by this examination. There were no reclassifications among balance sheet line items.

| | | | |
|---|-----------------|--------------------|---------------------|
| Surplus as regards policyholders December 31, 1999, per annual statement | | | \$43,987,370 |
| | Increase | Decrease | |
| Federal Income Tax Recoverable | | <u>\$2,910,733</u> | |
| Net increase or (decrease) | <u>\$0</u> | <u>\$2,910,733</u> | <u>2,910,733</u> |
| Policyholders' surplus December 31, 1999, per examination | | | <u>\$40,756,972</u> |

VII. SUMMARY OF EXAMINATION RESULTS

Compliance with Prior Examination Report Recommendations

There was one specific comment in the previous examination report. This comment contained in the last examination report and the action taken by the company are as follows:

1. Summary—The Company does not maintain currently in the State of Illinois, officers or personnel knowledgeable of the Company's financial records and annual statement preparation. Virtually all of the accounting functions and the annual statement preparation is conducted at the Employers Insurance of Wausau, A Mutual Company, Wausau, WI., office.

Action—Not applicable. Wisconsin does not have a law or regulation concerning the location of books and records or the location of personnel that prepare and maintain the books and records.

Summary of Current Examination Results

Reinsurance Recoverable

The examination noted certain discrepancies between Schedule F of the 1999 annual statement and the company's aging reports that track reinsurance balances. In some instances, the company listed all balances with respect to a given reinsurance treaty with just one of the numerous participants on a treaty on Schedule F. For example, participant #1120 on reinsurance contract #5470 is the only insurer designated on the aging report, even though it actually only had a 1.16% participation in the reinsurance contract. It is recommended that the company establish and maintain a verifiable record of the aging of reinsurance recoverable, with sufficient audit trails to permit comparison of annual statement data to specific reinsurance billings.

Federal Income Tax Recoverable and Interest Thereon

This line item represented the company's estimate of federal income tax recoverable that was allocable to it under Liberty Mutual Group's consolidated federal income tax policy. The company reported a balance for this line item of \$3,767,486 as of December 31, 1999, while this examination resulted in a balance of \$856,753. The examination made a downward adjustment of \$2,910,733, simply to reflect the difference between the updated estimate available at the time of examination fieldwork and the amount carried on the 1999 annual statement. This adjustment is reflected in the section of this report captioned, "Reconciliation of Policyholders' Surplus."

The examination noted that the company did not have a formally executed tax allocation agreement. A policy statement entitled “Draft # II – Liberty Mutual Group Tax Sharing Arrangement” was drafted on July 30, 1990, but never finalized and executed. The companies within the Liberty Mutual Group consistently follow an informal arrangement that approximates the terms of the draft agreement except that detailed separate company tax calculations, such as calculation of the alternative minimum tax on a separate company basis, are not always performed at the time of the tax provision. Instead, for provision purposes, each company is charged the tax effect of their regular taxable income at the time of the provision. The company has since executed a tax allocation agreement, which was approved by the OCI. Therefore, a recommendation on this subject is unnecessary for purposes of this examination report.

Losses and Loss Adjustment Expenses

Since January 1, 1999, the company has been a participant in a reinsurance pooling agreement with Liberty Mutual Insurance Company and certain of its property and casualty insurance subsidiaries and other affiliates. The company’s net loss and loss adjustment expense reserves are the product of the reserves of the Liberty Mutual Group Pool and the company’s participation percentage in the pool.

As part of its engagement by the Massachusetts Division of Insurance to assist in the overall examination of Liberty Mutual Insurance Company and Liberty Mutual Fire Insurance Company, PricewaterhouseCoopers LLP reviewed the adequacy of the company’s loss reserves and loss adjustment expense reserves, including the provisions for environmental claims, as a function of its participation in the pool.

The review was conducted in a manner consistent with the Code of Professional Conduct and the Qualification Standards of the American Academy of Actuaries and the Standards of Practice adopted by the Actuarial Standards Board.

The results of PricewaterhouseCoopers LLP’s actuarial review indicated that the company’s reserves at December 31, 1999, made an adequate provision for all unpaid loss and loss adjustment expense obligations of the company under the terms of its policies and reinsurance agreements.

Other Expenses

This line item represents incurred but unpaid other underwriting and investment expenses, excluding taxes, licenses and fees. The company reported a balance for this line item of \$941,212 as of December 31, 1999.

For a company within a holding company system of the size and complexity of the Liberty Mutual Group, the line item for "Other Expenses" consists of numerous accruals that can be made only through careful estimation in good faith. This examination conducted an extensive review of the accruals that comprised the line item for "Other Expenses" and determined that the company's estimates were reasonable overall. Omissions to accrue and under-accrual of executive compensation and benefit plans was the only exception to the overall reasonableness of the company's estimation procedures. The substantive effect of these omissions and under-accruals was not material, but the company should address this situation. It is recommended that the company estimate its liabilities with respect to each executive compensation and benefit program and record such estimates on future statutory financial statements.

Provision for Reinsurance

On March 25, 1999, OCI issued a permitted practice decision whereby the company may regard the Nationwide Indemnity Company treaty as satisfactory security with regard to the calculation of the Schedule F statutory penalty on authorized and unauthorized reinsurance recoverables covered by the treaty. This decision succeeded one dated December 28, 1998, whereby relief on the provision for reinsurance was limited to unauthorized reinsurance recoverables covered by the treaty with Nationwide Indemnity Company. Both permitted practice decisions were conditioned upon disclosure of the permitted practice in a note to each statutory financial statement issued by the company, together with a statement in this disclosure indicating the financial impact of the permitted practice. The disclosure upon which these permitted practice decisions were conditioned was not made in the 1999 annual statement.

The company's accounting procedures with respect to external reinsurance have changed to provide that WGIC cessions to non-affiliated reinsurers are no longer reported on an individual company basis. WGIC now cedes its net results to Employers Insurance Company of

Wausau, which accounts for external reinsurance specific to the Wausau Insurance Companies prior to the cession to Liberty Mutual Insurance Company. Therefore, the previous examination report's recommendation need not be repeated.

Subsequent Events

Since the conclusion of fieldwork on October 20, 2000, there have been a number of noteworthy developments with respect to the company's holding company system and management and control.

Mutual Holding Company Restructuring

In 2000, Liberty Mutual Insurance Company filed an application to restructure under a mutual holding company plan pursuant to the laws of the Commonwealth of Massachusetts. The laws of both Massachusetts and Wisconsin allow a mutual insurance company to convert to a stock insurance company by placing the mutual policyholders' ownership rights in a mutual holding company, which then becomes the owner of the newly-converted stock insurance company. On November 9, 2001, Liberty Mutual's policyholders approved the reorganization of their company into a mutual holding company structure, and on November 27, 2001, Massachusetts' Commissioner of Insurance approved the reorganization. On November 28, 2001, Liberty Mutual became a stock corporation under the control of Liberty Mutual Holding Company Inc., which contributed all of the issued and outstanding common shares of Liberty Mutual to LMHC Massachusetts Holdings Inc., which, in turn, contributed this stock to Liberty Mutual Group Inc. In this manner, Wausau General Insurance Company became a fifth-tier subsidiary of Liberty Mutual Holding Company, Inc.

Employers pursued a mutual holding company restructuring under the laws of the state of Wisconsin in tandem with the efforts of Liberty Mutual. Employers filed an application dated September 15, 2000, to restructure under a mutual holding company plan pursuant to ch. 644, Wis. Stat.

On November 9, 2001, OCI approved Employers' mutual holding company plan. On November 21, 2001, Employers converted to a stock corporation and was renamed "Employers Insurance Company of Wausau," one day after the affirmative vote of its policyholders.

Employers became a direct, wholly owned subsidiary of Employers Insurance of Wausau Mutual Holding Company.

On March 14, 2002, the members of Liberty Mutual Holding Company, Inc. voted to approve a merger of Employers Insurance of Wausau Mutual Holding Company with and into Liberty Mutual Holding Company, Inc. This merger was consummated on March 19, 2002.

Current Board of Directors

There have been certain changes to the board of directors since the end of examination fieldwork on October 20, 2000. As of December 5, 2002, the board of directors consisted of the following persons:

| Name and Residence | Principal Occupation | Term Expiry |
|---|--|--------------------|
| J. Paul Condryn III Walpole, Massachusetts | Senior Vice President and Chief Financial Officer Liberty Mutual Insurance Company | 2004 |
| Terry L. Conner Rye, New Hampshire | Senior Vice President and Chief Information Officer Liberty Mutual Insurance Company | 2005 |
| A. Alexander Fontanes Duxbury, Massachusetts | Senior Vice President and Chief Investment Officer Liberty Mutual Insurance Company | 2005 |
| Joseph A. Gilles Wausau, Wisconsin | President and Chief Operating Officer EMPLOYERS INSURANCE OF WAUSAU A Mutual Company | 2005 |
| Gary R. Gregg Milton, Massachusetts | Executive Vice President Liberty Mutual Insurance Company | 2003 |
| Edmund F. Kelly Weston, Massachusetts | President and Chief Executive Officer Liberty Mutual Insurance Company | 2004 |
| Christopher C. Mansfield Dedham, Massachusetts | Senior Vice President and General Counsel Liberty Mutual Insurance Company | 2003 |

Current Officers

There have been significant changes in officers since the end of examination fieldwork on October 20, 2000. As of December 5, 2002, the following persons served as officers of the company:

| Name | Office/Position |
|----------------------|---|
| Edmund F. Kelly | Chairman of the Board and Chief Executive Officer |
| Gary R. Gregg | Vice Chairman of the Board |
| Joseph A. Gilles | President and Chief Operating Officer |
| J. Stanley Hoffert | Vice President, General Counsel and Secretary |
| Juliana M. Coyle | Vice President and Treasurer |
| Robert D. Effinger | Vice President, Actuarial and Underwriting Products and Services |
| Martin J. Welch | Senior Vice President and Manager |
| Scott W. Hogan | Chief Financial Officer |
| J. Eric Brosius | Vice President and Manager, Domestic Reinsurance |
| Jeffrey R. Cole | Vice President and Manager, Custom Accounts |
| George W. Doonan | Vice President, Commercial Finance |
| Dexter R. Legg | Vice President and Assistant Secretary |
| Gary J. Ostrow | Vice President, Corporate Taxation |
| Paul A. Rodliff | Vice President |
| W. Craig Olafsson | Assistant Vice President, Counsel and Assistant Secretary |
| Diane S. Bainton | Assistant Secretary |
| James Pugh | Assistant Secretary |
| Lawrence H. S. Yahia | Assistant Secretary |
| Richard C. Cloran | Assistant Treasurer |

VIII. CONCLUSION

Policyholders' surplus has increased from \$28,419,212 as of year-end 1996, to \$41,076,637 as of year-end 1999, as adjusted by this examination. This represents an increase of 44.5% during the period under examination.

The following schedule summarizes the cumulative increases and decreases to surplus from December 31, 1996, when policyholders' surplus was last verified by examination, to December 31, 1999:

| | |
|---|---------------------|
| Policyholders' surplus, December 31, 1996 | \$28,419,212 |
| Net income | 13,618,856 |
| Net financial examination adjustments as of December 31, 1999 | (2,910,733) |
| Change in provision for reinsurance | 1,860,903 |
| Accounts payable | 542,321 |
| Change in nonadmitted assets | (311,971) |
| Discontinued business surplus adjustment | (176,772) |
| Other surplus items | 48,282 |
| Net unrealized capital losses | (13,501) |
| Change in excess of statutory reserves over statement reserves | 1,000 |
| Change in accumulated translation adjustment | <u>(960)</u> |
| Policyholders' surplus, December 31, 1999 | <u>\$41,076,637</u> |

Areas of improvement recommended by this examination included reporting liabilities for executive compensation and benefit plans and maintenance of audit trails in reinsurance accounting.

While the company is a separate legal entity, it derives all of its net retained business through a pooling arrangement with certain affiliates led by Liberty Mutual Insurance Company. All of the company's operations are conducted by employees of WSC and Liberty Mutual, and the results of WGIC's operations, other than investments and taxes, are pooled with participants in the Liberty Mutual Group Pool. The experience of the company relative to net premiums, liabilities, and net underwriting results will follow the experience of the affiliated pool. Therefore, the practices and procedures of pool participants, especially Liberty Mutual, which manages the pool, are critical to the operating results of the company.

IX. SUMMARY OF COMMENTS AND RECOMMENDATIONS

1. Page 34 - Reinsurance Recoverable—It is again recommended that the company establish and maintain a verifiable record of the aging of reinsurance recoverable, with sufficient audit trails to permit comparison of annual statement data to specific reinsurance billings.
2. Page 36 - Other Expenses—It is recommended that the company estimate its liabilities with respect to each executive compensation and benefit program and record such estimates on future statutory financial statements.

X. ACKNOWLEDGMENT

The courtesy and cooperation extended during the course of the examination by the officers of the company and employees of Wausau Service Corporation and Liberty Mutual Insurance Company is acknowledged.

In addition to the undersigned, the following representatives of the Office of the Commissioner of Insurance, state of Wisconsin, participated in the examination:

| Name | Title |
|-----------------------|---|
| Andrew M. Fell | Financial Examiner |
| David A. Grinnell | Financial Examiner |
| Steven F. Harwick | Financial Examiner |
| Mark A. Lasowski | Financial Examiner |
| Cruz J. Flores | Senior Insurance Examiner, Electronic Data Processing Audit Specialist |
| Frederick H. Thornton | Senior Insurance Examiner, Exam Planning & Quality Control Specialist |

Respectfully submitted,

Steven J. Junior
Examiner-in-Charge